

Sept. 19, 1990

LETTER 1052

LATEST: The 12-month addition to the federal debt (this is the true deficit) is at a new high of \$381.2 billion or \$7.33 billion a week!

WHA? I've already named 1990 the "What's It?" year. None of the "experts" agree on anything. Is this a bear market? Is the US in recession? Is the US at war? Does Gramm-Rudman stand for anything? Take your pick. It's multiple-choice time (Of course, I do take a stand -- we're in a primary bear market, believe it or not).

IRAQ: The hawks say stop Hussein now or face a future with Hussein plus nuclear weapons. Or as *US News and World Report's* publisher put it (Sept. 10): "Those who shrink from stopping him today should realize that the cost of stopping him tomorrow will be much higher and may even be impossible."

The disbelievers claim that we're trading US sweat and maybe blood for "cheap oil" and that we never should have put our troops in the Saudi Arabian desert in the first place.

President Bush has been under increasing pressure to spell out his goals in the Middle East. On September 11, I felt he took his stand. Hussein "will fail," he stated. With that statement, Bush implied that if all else fails, the US will go the military route. But first, said Bush, patience. And that's the story so far.

THE MARKET: The stock market is oversold, and it's been oversold since early July. As I said in the last Letter, there's a good and a bad side to this. The good side is that an oversold market (even when the primary trend is bearish, as it now is) tends to be resistant to decline. The bad side is that it's a characteristic of primary bear markets that they can remain oversold for extended periods of time (in the current case this market has been oversold for two-and-a-half months). In other words, what we've been seeing here in 1990 is typical bear market action.

Analysts who have grown up since 1974 have never seen a true primary bear market in action. Thus, they have remained bullish (or mystified) by the stock market's refusal to push skyward as soon as it is oversold. In a bear market, things don't work the way they work when the primary trend is up. Dullness doesn't lead to rallies. Oversold conditions don't necessarily lead to rallies. In a bear market, the bears are right. Thus, the normal sentiment indicators go haywire in a bear market, and widespread pessimism doesn't necessarily lead to rallies.

First things first. I want to include here some markers for this primary bear market, and the best place to start is by pinpointing the highs for the preceding bull market (the highs, of course, are the levels where the bear market started).

D-J Transport high: 1532.01 on 9/5/89
Value Line Composite high: 278.98 on 10/9/89
AMEX high: 396.52 on 10/9/89
NASDAQ Indust. high: 510.61 on 7/16/90
D-J Utility high: 236.23 on 1/2/90
D-J Industrial high: 2999.75 on 7/16/90

Sept. 7 DJIA 2619.55; PTI 3240; A-D Ratio -14.25
Sept. 14 DJIA 2564.11; PTI 3220; A-D Ratio -14.86
Dow Yield: 4.15%; Dow P/E: 12.5; DowPow: -506
Dow Book Value: 1276; Dow 200-day MA: 2744
Percentage of Undervalued Blue-chips: 31%
PTI 89-day Moving Average: 3264

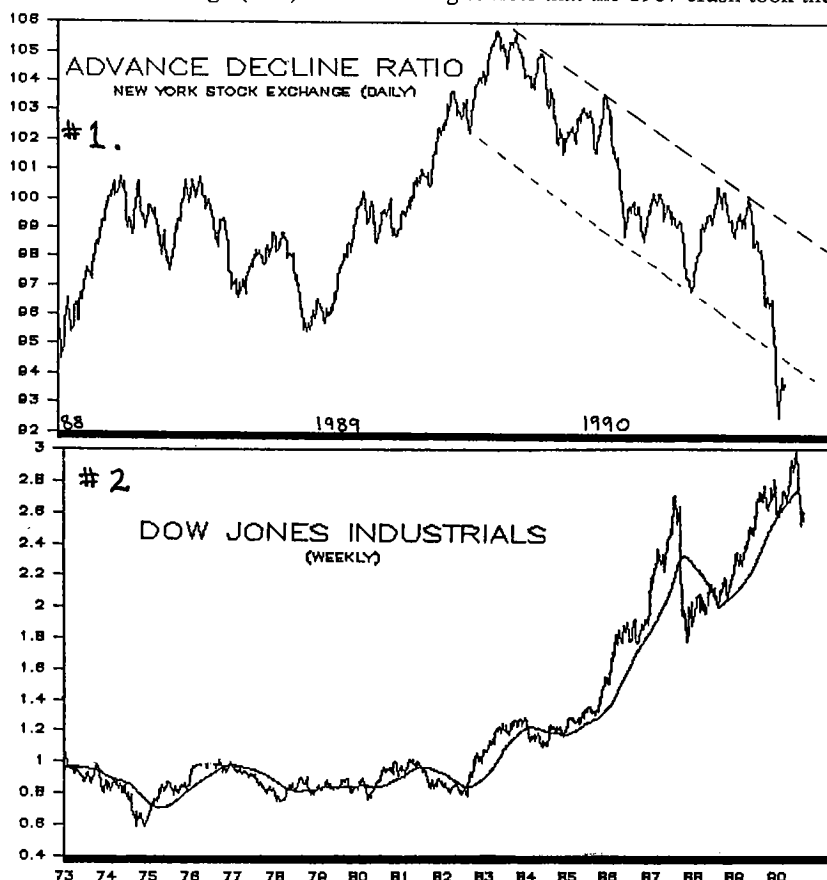
S&P 500 high: 368.95 on 7/16/90
NYSE Composite high: 201.13 on 7/16/90

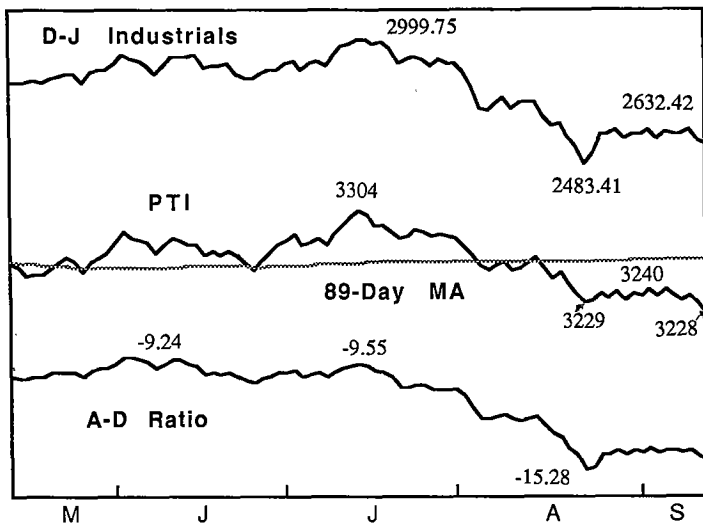
Next subject: every once in a while I find it enlightening to do a chart-oriented Letter. This is one of those Letters, and I think the charts I'm going to present will give you a good idea of what's really happening. So here goes (all charts in this series are courtesy of Paul Eldridge and the *Ruff Company*, unless otherwise noted):

The first chart (#1) is very fundamental. It shows the **NYSE advance-decline ratio** (breadth) from 1988 to the present. Breadth topped out in August 1989 and except for sporadic rallies, it has been going down ever since. As this is written, the breadth (incredibly) is very near its late-1985 level, at which time the Dow was in the 1300s. That's something to think about.

One of the reasons the A-D ratio is important is because it's a good proxy for the average investor's portfolio. So you can see that the bear has been exacting its toll on most investors. The chart is also interesting because it shows that the bear market in the majority of NYSE stocks has been in force for over a year. The Mideast crisis, as far as Wall Street was concerned, is simply "more of the same."

The second chart (#2) shows the **Dow** and its long-term moving average (MA). It's interesting to note that the 1987 crash took the



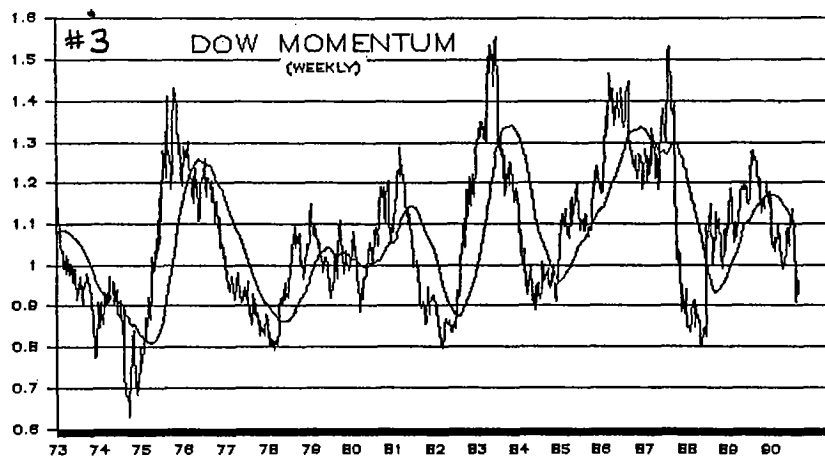


Dow well below the MA. The second crash in 1989 took the Dow down to, but not below, the MA. And the current bear market has taken the Dow below the MA again. The Dow (and all the major averages) have now broken well below their lows of the last quarter of 1989, and that's never a good sign.

Below the Dow chart is a chart (#3) of **Dow momentum** (based on rate-of-change). Note here that on a longer-term weekly basis, Dow downside momentum has not reached anywhere near the massive oversold areas of late-1974, 1978, 1982 or 1989.

To me, the 1984 momentum collapse of 1974 to below 0.7 is particularly interesting. This total smash in momentum ended the 1973-74 bear market with the Dow at 577. That's the kind of action that tends to end major primary bear markets.

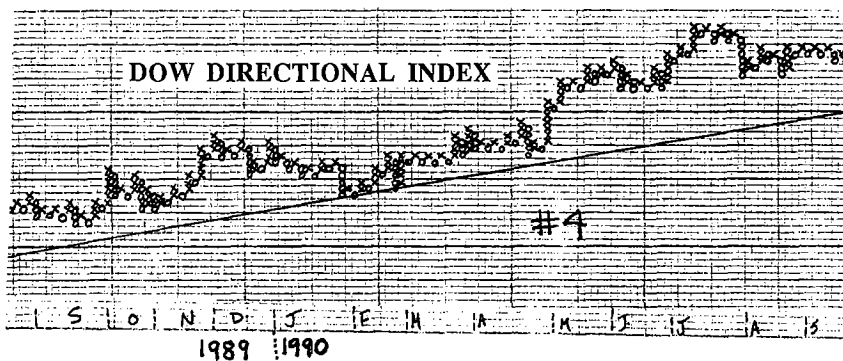
Next is my own chart (#4) of a study which I call the **Dow Directional Index (DDI)**. To me, this is one of the major mysteries of this market. The chart is simply an up-down P&F chart -- an X is entered on each day when the Dow moves up and a O is entered on each day when the Dow declines.



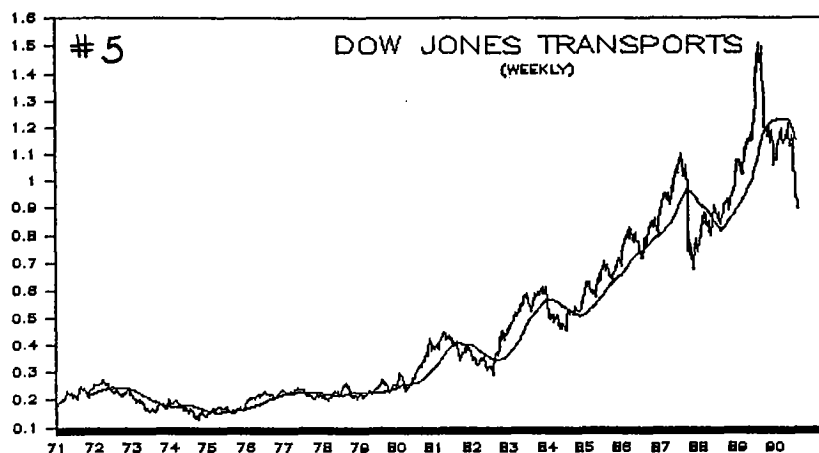
Here's the amazing fact: the Dow lost a total of 517 points from top to bottom in 1990 -- yet the DDI has retained its bullish trend -- it just hasn't broken down.

And I ask myself -- what's the meaning of this? Is the Dow stronger than it appears? Has program trading and manipulation changed the geometry of the Dow? Is the DDI telling us that the Dow just doesn't want to fall apart, despite the collapse in breadth? Or does the real bear market still lie ahead? Now here's a frightening thought -- if the Dow can drop 517 points while the DDI remains bullish, what will happen to the Dow when the Dow Directional Index finally reverses and sinks into a bear trend?

The next chart (#5) presents a long-term view of the **D-J Transportation Average**. This Average went into a parabolic rise. The rise ended in a spear-point top on September 5, 1989. From there Transports crashed, breaking far below their long-term MA. Note on the rally off the crash low that the Transports touched the declining MA, then fell away again. At its recent low of 861.31 (down 670.69 points from the high), the Transports had lost a whopping 43.8% of their peak value!).



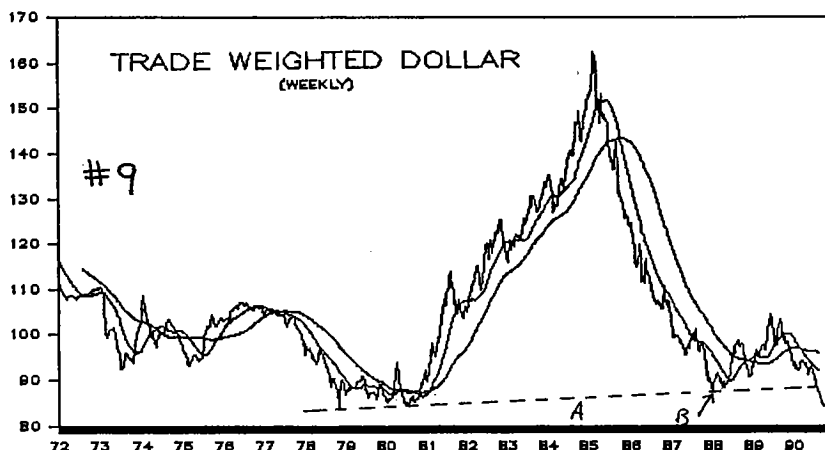
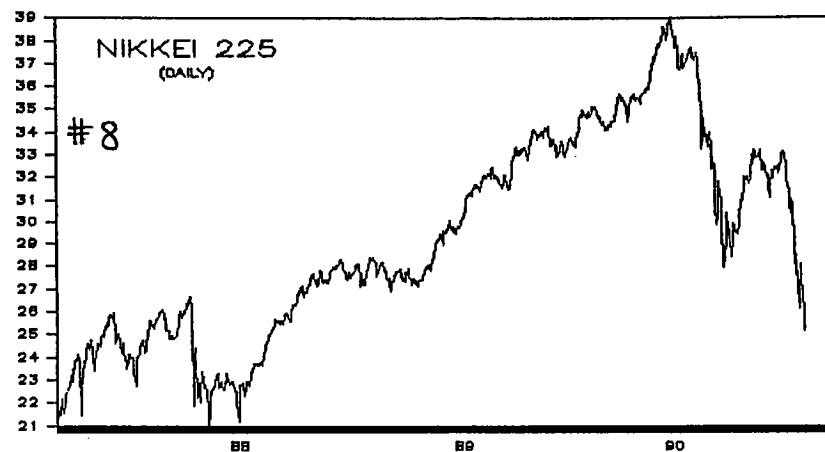
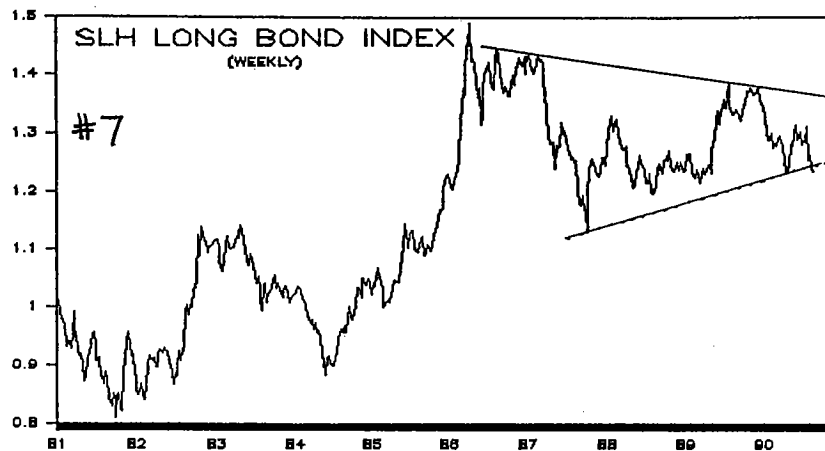
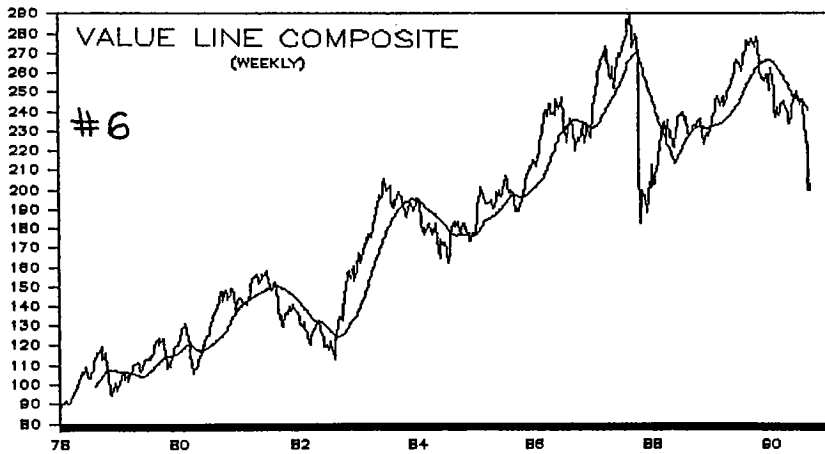
This chart (#6) shows the widely-followed **Value Line Composite**. The Value Line (like the A-D ratio) is often used by analysts as a proxy for the portfolio of the average investor. Here we see that the Value Line has wiped out more than half of its gains since the 1987 crash lows. Before this bear market is over, I expect the Value Line to break below its '87 crash low.



This chart (#7) shows **Shearson's Long Bond Index**. The Index has formed a huge triangle effect with a declining top line and a rising bottom line. As this is written, the Long Bond Index is in the process of breaking below its lower trendline, and that's a bearish break.

One thing that has bothered me about bonds (and I wrote about this last year) was that the public had loaded up on them. On top of this, a few of the major brokerage houses had taken out full page ads extolling the wonders of bonds. I have never seen the public load up on anything and come out ahead, so the public's new-found fascination with bonds bothered me. And still does.

I feel that the long-term bond market could be hit and hit hard as this bear market progresses. Of course, it's hardly comforting to bond holders to see the federal



deficit and debt balloon out of sight. But our politicians now have the Middle East mess to get them off the hook (in other words, "We have a new and more important emergency to deal with, and this far outweighs the problem of the budget deficit.").

Here we see the Nikkei 225 (chart #8), with what looks very much like a classic bear signal. Japan (unlike Germany) has only one major market that it exports to -- and that market is the US. If the US sinks into recession, then the US will be cutting back sharply on all imports including those from Japan.

I've long suspected that the unwritten trade-off between the US and Japan runs something like this -- "You (Japan) continue to buy our debt in the form of T-bonds, and we'll supply the military protective umbrella. We'll also see that you (Japan) get a good deal out of Washington as far as taxes and trade are concerned." By the way, note how little Japan is contributing towards the Mideast situation (Germany, too, for that matter).

Primary bear markets are always international in scope, and the Japanese stock market has been vastly overpriced. Furthermore, one of the impetuses behind the tremendous rise in the Japanese stock market has been the incredible rise in its real estate prices. Over the last year, real estate prices in Japan have been coming down hard. So has its stock market.

As a footnote, I might add that the Japanese have been big buyers of high-priced art and high-priced auction items of all varieties. With the advent of a bear market in Japan, the picnic in the auction market may well be over. Sotheby's stock has now dropped from its bull market high of 37 to the recent low of 10 1/8.

Here's a chart (#9) that does not get enough attention. It's the trade-weighted dollar. What we see here is the dollar breaking below key support and dropping to its lowest level in a decade. How did it happen? It happened because the US is playing a deadly game. It's a game based on the question -- "How far can you pyramid your debts and deficits before your currency collapses and your Treasury issues become 'junk bonds'?" The answer: "We don't know yet, but the way we're going the answer should be forthcoming fairly soon."

With the US federal debt pushing towards the \$4 trillion mark, it's becoming increasingly obvious that America's debt (1) will be inflated away or (2) defaulted upon. Question: we know how the debt can be inflated away (the US has been doing that for decades), but how could the debt sink into default? A severe recession could run the federal deficit through the roof and the bond market through the floor. Under such conditions, US debt could literally go into default (actually, there would have to be some sort of major reorganization).

This bear market (like all primary bear markets) has been global in scope. You doubt it? Then study this most interesting statistical rundown (page 4) just published by David Fuller (*Fuller Money*, 7 Swallow Street, London W1R 7HD, United Kingdom).

Conclusion: This is a bear market, but strangely, even after a year of the bear, the market has not fallen apart the way it did, say, in 1973-74. Is this a hopeful indication -- or is the worst yet to come? Obviously, no one can possibly know, but my guess is that somewhere ahead we're going to have to deal with a much more destructive bear.

The Global Bear Market

and it isn't over

Market	Bull Peak	Bear Low	% Decline to date
Australia (All Ord)	1782 (8/89)	1467 (4/90)	-18%
Austria (Credit Ak)	703 (3/90)	467 (8/90)	-34%
Belgium (SE Index)	6805 (9/89)	5244 (8/90)	-23%
Canada (Tor Comp)	4038 (10/89)	3334 (5/90)	-17%
Denmark (CSE)	388 (7/90)	348 (8/90)	-10%
Finland (Unitas)	815 (4/89)	515 (8/90)	-37%
France (CAC Gen)	565 (5/90)	418 (8/90)	-26%
Germany (FAZ)	832 (7/90)	655 (8/90)	-21%
Hong Kong (Hang Seng)	3560 (7/90)	2871 (8/90)	-19%
Italy (BIC)	764 (6/90)	584 (8/90)	-24%
Japan (Nikkei)	38,916 (12/89)	23,738 (8/90)	-39%
Malaysia (KLSE)	632 (8/90)	481 (8/90)	-24%
Netherlands (CBS All)	211 (9/89)	176 (8/90)	-17%
New Zealand (Barclays)	2455 (8/89)	1538 (8/90)	-37%
Norway (Oslo SE)	915 (8/90)	826 (8/90)	-10%
Philippines (Manila C)	1396 (11/89)	684 (8/90)	-51%
Singapore (Straits Times)	1607 (3/90)	1128 (8/90)	-30%
South Africa (JSE Ind)	3211 (2/90)	2738 (8/90)	-15%
South Korea (Composite)	1003 (3/89)	594 (8/90)	-41%
Spain (Madrid SE)	328 (9/89)	235 (8/90)	-28%
Sweden (Affaer GI)	1373 (8/89)	1086 (8/90)	-21%
Switzerland (Swiss B I)	845 (7/90)	654 (8/90)	-23%
Taiwan (WPI)	12,495 (2/90)	3136 (8/90)	-75%
Thailand (Bangkok SET)	1144 (7/90)	735 (8/90)	-36%
UK (FTSE 100)	2464 (1/90)	2075 (8/90)	-16%
USA (DJIA)	3000 (7/90)	2483 (8/90)	-17%
Average bear market decline to date			-27%

There's still a great deal of faith that the government will somehow "bail us out" or that the Fed will "make everything all right." Maybe so, but I continue to operate on the thesis that bear markets correct excesses the hard way, and that ultimately primary

bear markets take common stocks down to the point where they represent "great values." On that basis, my opinion is that this bear market still has a long way to go.

INVESTMENT POSITION:

For the past few months it's been "correction time in America," and a lot of the items that were hit by the bear have been correcting -- stocks, bonds, the dollar. But the upside corrections were weak, listless, low-volume and unconvincing. Then, over the past week, the bear has taken over again. The constant question: Should one try to beat the bear?



NOTES and QUOTES: The *National Enquirer* states the following: Dr. John Laffin, a world-famous British expert on Arab affairs and author of *The Arab Mind*, told the Enquirer, "My contacts have informed me that Hussein has put out a very large reward for the assassination of Bush." The tabloid further states that top anti-terrorist Isaac Yeffet with contacts throughout the Arab world confirmed, "I know, without any doubt whatsoever, that Saddam Hussein issued an order to his terrorist groups to kill President Bush." A third source, a Kuwaiti official, is quoted as follows: "Hussein put a \$100 million price on President Bush's head a week after Iraqi troops invaded Kuwait. Hussein held a secret meeting in Baghdad with several feared international terrorists including Abu Nidal, Abu Abbas, Abu Ibrahim and Carlos. Hussein told the terrorists that he controlled a billion dollars in gold bullion in Kuwait. He said, '\$100 million is yours when Bush is dead.'" Russell comment: I hope the Secret Service knows about all of this.

Who is Saddam Hussein? My old high school chum, Donald Morris (formerly with the CIA and now publishing his own syndicated newspaper column), gives us the inside story: "Hussein's childhood was traumatic. He was born posthumously in 1935 to an ugly, vile-tempered shrew with three sons by her first husband; her third husband, Saddam's step-father, was known locally as 'Hassan the Liar.' He beat his step-children regularly with sticks, and, Fagin-like, set them to steal. Saddam served one stretch in a detention home, committed his first murder in his teens, and had killed three more men before a celebrated 1959 attempt to assassinate General Abu al-Karim Qusim, who had overthrown the monarchy in a bloody coup the year before (Saddam's uncles and half-brothers were also thieves and murderers; as in the Mafia, "to make your bones" was a rite of passage.). This was quite enough to get Saddam appointed head of the Ba'ath party death squad, his first political step upwards.

"Qusim was murdered in 1963; Saddam rose in the Ba'ath party, and took control in 1979. He formed an inner circle of close relatives and Takriti villagers, who occupied virtually every position of power in Iraq. One half-brother is Chief of General Security, another Chief of Intelligence. Saddam controls them with a two-edged sword. He has no compunction about executing opponents, and he has forced the Takriti to participate in his butcheries. Hussein's despotism is notorious. In a 1979 pro-Syrian Ba'athist plot, he decimated the party leadership, personally supervising the mass executions. In 1985, when the loyalty of Ad Dujayl was in question, its 2,000 inhabitants were massacred and the village wiped out." Russell Comment: So that's the guy we're up against, a real sweetie if there ever was one (*The Donald Morris Newsletter*, PO Box 199009, Houston, TX 77224).

The "budget boys" in Washington haven't been able to agree on much when it comes to raising what taxes or cutting what spending plans. The current imperative -- to lower the Gramm-Rudman targets so that Washington can avoid the \$100 billion in cuts ("sequestrations") that are mandated by Gramm-Rudman. The excuse for belated or even no action on the budget will be (1) "Hussein did it" and (2) "the nation must avoid recession at any cost."

How bearish are the pros? A September 10 *Barron's* cover story piece shows the pros cautious but none expecting a decline to lower than Dow 2200. Meanwhile, consumers don't seem too worried. In July, they added a whopping \$4.5 billion to their debt load (\$3.8 billion of it onto their credit cards).

Currently, the so-called purchasing power parity for the dollar is unquestionably in favor of the dollar. The dollar, in terms of what it can buy here in the US, is cheap. Assuming you skip meat, go into a super-market here and you can load up with vegetables, bread, soft drinks and so forth -- all on a twenty-dollar bill. Go to an Italian or British market and see what you get for comparable money.

The old philosophy states, "You pays your money and you takes your chances." Fair enough, but my philosophy is this -- I can't make any real money in the market unless I have the mindset and conviction to take a major position. Taking a small position in a hoped-for correction against the major trend isn't worth the gamble. Even if I am lucky enough to scalp the market -- on an after-tax basis the potential return isn't worth it.

So personally, I'm playing it like the bear market that it is -- staying very liquid -- in T-bills, money market funds, Swiss francs, German marks and gold coins.

The bear hasn't got a full grip on the bull's throat yet -- but he's getting there. On September 13, my Primary Trend Index (PTI) broke to a new low since its July peak. The Averages seem to want to test their August 23 bear market lows. Those lows were D-J Industrials **2483.41**, Transports **861.31**. A joint breaking of these lows would, I believe, set the stage for a messy and costly fall season. The market, as I see it, is saying that a recession (and very likely a severe one) is in the bag.

The latest issue of the *Bank Credit Analyst* has this to say: "The US is in relative decline as a global economic power. National balance sheets have been eroding and net foreign debts have risen alarmingly. The social fabric of the nation has deteriorated hand-in-hand with stagnation in real living standards for most of the population. In addition, the failure to reduce the federal deficit is a damning indictment of the inadequacies in the policy-making process. The background for the dollar will remain consistent with a long-term secular bear market."

In a later section, *BCA* adds: "The background for the US dollar appears dismal. The US has the lowest short-term interest rates in the industrialized world, the economy is on the verge of recession, fiscal policy is in shambles and policy makers do not care if the currency falls . . . The dollar has received little benefit from its status as a safe haven in a time of geo-political strife. Economic risks in the US far outweigh any perceived advantage of political security. The relentless decline in the economic performance of the US relative to other industrialized economies is slowly eroding the dollar's historical position as the world's premier currency."

Russell Comment: That's not the whole story. The global markets look at interest rates, debt, central bank policies, a nation's trade position, future financing, and the trend of inflation. On that basis, the dollar faces a dismal future. As I see it, the dollar today has purchasing power parity and the shrinking trade balance going for it. But if the price of oil stays high, even the US trade balance will suffer. So I'm not a bull on the dollar. And the added expense of Iraq plus the jettisoning of any real budget reduction plans makes me even less hopeful for the trend of the greenback.

"Benign neglect" continues to be the Administration's policy towards the dollar. This clip is from the September 10 *NY Times*. Here's Treasury Secretary Brady (the Treasury Secretary is supposed to be the guardian of the currency) coming out and pressuring the Fed for lower rates. Lower rates, of course, would undermine the dollar's value in the international market. And so it goes with this Administration.

Brady Urges Lower Rates

WASHINGTON, Sept 9, (Reuters) — Treasury Secretary Nicholas F. Brady renewed his call for the Federal Reserve Board to sanction a cut in interest rates and said the dollar's fall was not precipitous. He made his comments to report-

Mr. Brady said the American economy was more resilient than many private economists believe. Because the economy has shown some slow growth, it might be more difficult to push it into a recession, he said. His comments came after being

Love Inflation: If you buy a home at the national average price of \$150,000 with an 8% twenty-year mortgage, by the end of the twenty years, you'll have paid almost \$400,000 for your little home (obviously more if the mortgage rate was higher). What happens if the nation deflates? You'll have paid a huge amount over the years for a home that's been declining in value. And that, in a nutshell, is why so many Americans love inflation.

On September 11, the General Accounting Office stated that the nation's banking system is so fragile that a recession could send major banks into bankruptcy and also bankrupt the FDIC. Comptroller Bowsher on the same day reported that the banking industry is plagued by billions of dollars in losses that are not yet identified by federal regulators. He added, "Not since its birth during the Great Depression has the federal system of deposit insurance for commercial banks faced such a period of danger and uncertainty as it does today."

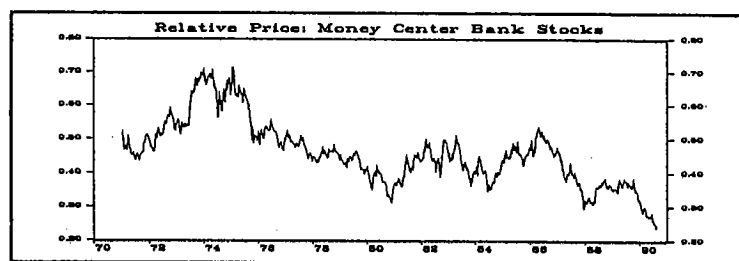
The Soviets now owe a total of \$64 billion in hard currency. They are also running six months behind in payments to Western suppliers to whom they owe between \$2 and \$5 billion. The boost in oil prices has helped the Soviet situation, but they have been major sellers of gold. It was thought that the Soviets had \$25 to \$32 billion in gold, but the CIA now thinks that the Soviet gold

stock is below \$15 billion. Some observers now claim that there is no Soviet empire any longer -- just a collection of bankrupt and inept provinces, frantically trying to stay above water.

In 1981 Israel raided Iraq and bombed out Iraq's nuclear reactor, thus also destroying their nuclear capabilities. From *Fortune* magazine, here are some of the comments, (made at the time) about that raid: From an editorial in the *Christian Science Monitor*: "The world can only greet with sadness and regret that Israel has chosen the path of an outright aggression." From an editorial in the *Washington Post*: "In knocking out the Iraqi nuclear reactor, the Israelis have made a grievous error, acting in a way contrary to their own long-term interests and in a way contrary to American interests." From an editorial in the *New York Times*: "Israel's sneak attack on a French-built nuclear reactor near Baghdad was an act of inexcusable and shortsighted aggression."

And one wonders where the world would be now if Israel had not knocked out Hussein's nuclear capability back in 1981. Israel is now in favor of getting rid of Hussein. Israel believes there will be no peace while Hussein rules Iraq. In case you weren't aware of it, Israel has never been known for rotten intelligence work.

The stock market has been preparing for the banking crisis for a long time. Here's a chart, courtesy of Merrill Lynch going back to the early-1970s showing the relative strength of the money center banks. Wall Street may have ignored it, but Wall Street also saw it coming.



Following are words from Lee Iacocca, from a column in the August 28 *Automotive News*: "I'm no expert on the Middle East, and I'm no expert on oil. But I knew this would happen. What's happened in the past few weeks was absolutely inevitable. And it's a failure of public policy that we weren't ready for it."

"Meanwhile, there's no movement for a coherent national energy plan. We continue to substitute politics for policy. We're hostages to Middle East oil and will be for years to come. And we don't seem to be able to grasp the fundamental reality that any nation that is not energy independent is not independent."

"On the day Hussein marched into Kuwait, the tax on a gallon of gasoline in Japan was \$1.32. In the US it averaged 32 cents. That's a big reason why Japan has cut its dependence on foreign oil nearly in half in the past decade while ours has actually gone up."

The guys are getting bigger. National Football League statistics show that in 1958 the average football player was 6'1.5" and weighed 216 pounds. Today he is 6'2" and weighs 231. Of course you wonder if steroids made the difference. The salaries have also inflated. Of the 28 starting quarterbacks, 15 are making over \$1 million a year, with six making \$1.5 million or better (Joe Montana makes \$2.55 million and Jim Everett makes \$2.4 million). Of course, if you're Mike Tyson or Sugar Ray Leonard those are mini-incomes.

Talking of incomes, the \$8 to \$10 boost in the price of oil means a monthly rise of roughly \$2 billion in Saudi Arabia's income. Secretary of State Jim Baker would like to get about \$500 million of that each month for the care and keeping of US forces, and it seems the Saudis have said OK.

The story runs like this: when the recession arrives and home prices sink, people will find that what they owe on their homes (i.e., the mortgage) is more than the market value of the house. So they'll just walk away -- rent somewhere else and save the money. Or they'll just dump the house and write off the loss. Great thinking, but there are a few catches. The IRS states unequivocally that you cannot deduct a loss on the sale of a home. Worse, it turns out the bank that wrote the mortgage can legally run after you and garnishee your salary or even grab your other assets. Final blow -- the IRS can come after you, stating that you owe taxes on income from a "forgiveness of debt," this despite the fact that you've already taken a beating on the sale of your house.

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We've just landscaped our front yard with a low-water desert planting -- Cacti and Succulents. Four days after the planting was completed, some thieves in the night stole four of our big barrel Cacti. How low will people stoop? Well, the statistics show that this year one out of every four American families will be a crime victim, from murder to robbery to car theft to you name it. The current issue of *New York* magazine features a cover story entitled, "All About Crime." The article begins thus: "In the next 24 hours, 5 New Yorkers will be killed, 9 will be raped, 256 will be robbed, 332 homes and stores will be burglarized and 367 cars will disappear. That's if things don't go too badly."

LA shouldn't feel left out. Last month there were 266 murders in LA County alone. Now here's an interesting item from AP: some New York kids are wearing bulletproof clothes to school. Cost of the Kevlar lined suits run from \$250 to \$600. Also being sold are bulletproof book bags and clip boards. Russell suggestion: Next time you're tempted to go to NYC or LA, lie down and wait until the urge goes away.

Further Russell Comment: I grew up in New York City during the Great Depression, and in those dark days crime was nothing like it is today. I could walk almost anywhere in NYC without fear of being accosted or mugged. I could leave my car on the street unlocked and be certain that I would find it there in the morning. Crime on the subway was almost unheard of. Things change.

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I've long felt that one of the root causes of today's crime and immorality is -- inflation. After all, let's face it, the government itself indulges in the economic crime (and it is a crime) of degrading our currency. I believe that the immorality of inflation gradually seeps into the national consciousness.

After living through decades of inflation, people feel robbed. Their savings have disappeared, they've been stolen by monetary degradation. So people cease to save, they simply lose the desire to save. Avarice and excuses and lies run rampant. So does crime. People lose confidence in their leaders, and they lose confidence in Congress. The fact is that the sight of the US dollar going down is not only ominous, it's a national disgrace. So is the US crime rate.

GOLD: Gold is base-building. The 1980-85 bear market for gold ended in 1985 at a price of 288. From there a new primary bull market began. From the 288 low, gold climbed to a high of 500 in 1987, then corrected to a low of 346 in 1990.

This is a 10 x 30 point and figure chart of spot gold. Each box on the chart represents 10 points, and only reversals of 30 points or more are depicted. In other words, this is a very concentrated picture of over 10 years of action in gold.

The chart shows the last bull market run-up in gold to the 1980 high area of 840-50, then the long bear market drop to the 288 level in 1985. What is clear on the chart is the massive consolidation pattern which has taken place since 1985. It is also clear that the action in the current area is simply backing and filling. The next move of major importance for the gold bull market would be a breakout above the 500 level shown by the two arrows on the chart. Such a move would also reverse the bearish trendline drawn from the 1980 high and put gold in position to challenge the 700

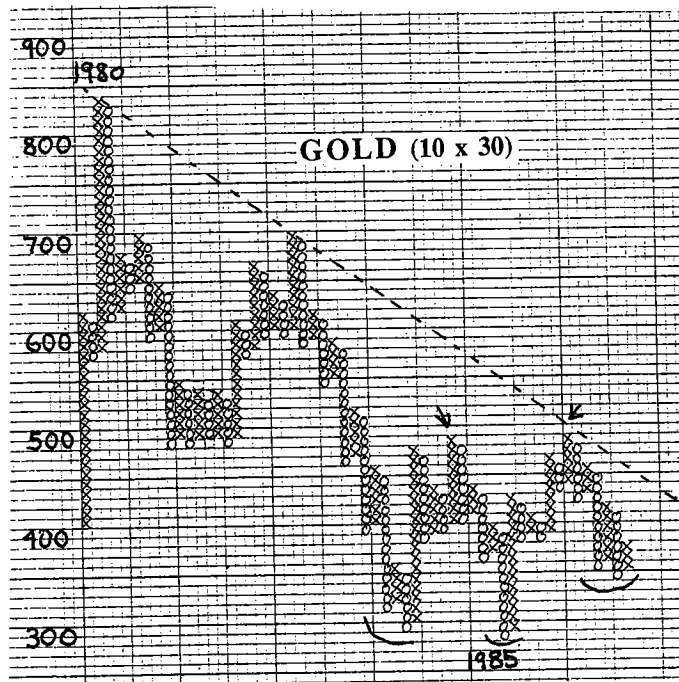
peaks which were established in the early 1980s. That then, is the big picture for gold.

What's the fundamental background for gold today? First, there is major competition at the currency-interest rate level. With hard currencies such as the German mark and the Swiss franc yielding 8-9%, investors have been opting for yield vs. gold.

However, it is a fact that the dollar represents a major part of the reserves of Germany, Switzerland and every central bank throughout the world. The dollar has been sinking in value. Furthermore, US finances are in disarray, and the US is on the verge of recession (if it is not already in one). The prospect of recession presents the probability of enormous deficits through the remainder of 1990 and beyond. This will require a reversal of the Fed's current "anti-inflationary" stand. Massive amounts of new credits will be issued, and the dollar will sink to new lows.

As the predicament of the dollar is perceived, investors here and overseas are going to have to do some soul-searching. At some point ahead, investors are going to move at least partially to the safety of the only money which is not someone else's liability -- gold. At present, in the US alone, there are \$4 trillion in liquid assets (bank deposits, CDs and money market funds). Against that the world is producing roughly \$29 billion of gold annually. If a tiny percentage of the liquid assets of the US alone were to move into gold, the metal would take off. If an even smaller percentage of the world's liquid assets were to move to the safety of gold, we would see the gold bull market explode.

Somewhere ahead I believe we will see a rush for gold. I don't know when it will start or from what level. That is why I have been advocating monthly fixed-dollar purchases of gold coins. Gold is now base building. When you dollar-average gold here, you are buying into that base.



LATE NOTES: Many analysts are flabbergasted because this oversold market continues to act weak to sloppy when it's "supposed to rally." What's wrong? This is a bear market, that's all.

Bearish signal: on August 30, the shorter-term 30-day moving average of the Dow dropped below the long-term 200-day MA of the Dow. The Dow itself is below both the 30-day and the 200-day MA. Thus the Dow and the two MA's are in the bearish mode. Much more on this in the next Letter.

NEXT MAILING: October 3